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ACCOUNTING BY SMALL AND MEDIUM-SIZED ENTERPRISES *

Report by the Ad Hoc Consultative Group of Experts on Accounting by Small and Medium-Sized Enterprises

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Guideline 2. Cash Flow Statements

Presentation of a cash flow statement

2.1 The cash flow statement should report cash flows during the period classified by operating, investing and financing activities.

2.2 Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the enterprise. Therefore, they generally result from the transactions and other events that enter into the determination of net profit or loss. Cash flows arising from income taxes should be separately disclosed within the operating activities section. Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in the determination of net profit or loss. However, the cash flows relating to such transactions are cash flows from investing activities.

Investing activities

2.3 The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows.

Financing activities

2.4 The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the enterprise.

2.5 An enterprise should report cash flows from operating activities using either:

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or
(b) the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

2.6 An enterprise should report separately major classes of gross cash receipts and gross cash payments arising from financing and investing activities, except to the extent that cash flows described in paragraph 2.7 are reported on a net basis.

2.7 Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

(a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the enterprise; and

(b) cash receipts and payments for items in which the turnover is quick, the amounts are large and the maturities are short.

2.8 Investing and financing transactions that do not require the use of cash or cash equivalents should be excluded from a cash flow statement. Such transactions should be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

2.9 An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the balance sheet.

Cash and cash equivalents

2.10 Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. To qualify as a cash equivalent, an investment must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents – for example, in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date.

2.11 Bank borrowings are generally considered to be *financing activities*. However, in some countries, bank overdrafts that are repayable on demand form an integral part of an enterprise's cash management. In these circumstances, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates between being positive and being overdrawn.

Other disclosures

2.12 An enterprise should disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the enterprise that are not available for use by the enterprise.

Guideline 3. Property, Plant and Equipment

3.1 An item of property, plant or equipment should be recognized as an asset when:

(a) it is probable that future economic benefits associated with the asset will flow to the enterprise; and
(b) the cost of the asset to the enterprise can be measured reliably.

3.2 An item of property, plant orand equipment which that qualifies for recognition as an asset should initially be measured at its cost.

3.3 The cost of an item of property, plant or equipment comprises its purchase price, including import duties and non-refundable purchase taxes, and any directly attributable costs of bringing the asset to working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price. Examples of directly attributable costs include the following:

(a) the cost of site preparation;
(b) initial delivery and handling costs;
(c) installation costs;
(d) professional fees such as for architects and engineers; and
(e) the estimated cost of dismantling and removing the asset and restoring the site, to the extent that it is recognized as a provision under Guideline 8.

3.4 Administration and other general overhead costs are not a component of the cost of property, plant and equipment unless they can be directly attributed to the acquisition of the asset or bringing the asset to its working condition. Similarly, start-up and similar preproduction costs do not form part of the cost of an asset unless they are necessary to bring the asset to its working condition. Initial operating losses incurred prior to an asset's achieving planned performance are recognized as an expense.

3.5 The cost of a self-constructed asset is determined using the same principles as for an acquired asset.

3.6 An item of property, plant or equipment may be acquired in exchange or part exchange for a dissimilar item of property, plant or equipment or other asset. The cost of such an item is measured at the *fair value* of the asset received, which is equivalent to the fair value of the asset given up adjusted by the amount of any cash or cash equivalents transferred.

3.7 Subsequent expenditure relating to an item of property, plant or equipment that has already been recognized should be added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally

assessed standard of performance of the existing asset, will flow to the enterprise. All other subsequent expenditure should be recognized as an expense in the period in which it is incurred.

3.8 Expenditure on repairs or maintenance of property, plant and equipment is made to restore or maintain the future economic benefits that an enterprise can expect from the originally assessed standard of performance of the asset. As such, it is usually recognized as an expense when incurred. For example, the cost of servicing or overhauling plant and equipment is usually an expense since it restores, rather than increases, the originally assessed standard of performance.

3.9 Major components of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of usage, or aircraft fixtures such as seats and galleys may require replacement several times during the life of the airframe. The components are accounted for as separate assets because they have useful lives different from those of the items of property, plant and equipment to which they relate. Therefore, provided the recognition criteria in paragraph 3.1 are satisfied, the expenditure incurred in replacing or renewing the component is accounted for as the acquisition of a separate asset and the replaced asset is written off.

Measurement subsequent to initial recognition

Benchmark treatment

3.10 Subsequent to initial recognition as an asset, an item of property, plant or equipment should be carried at its cost less any accumulated depreciation (3.19) and any accumulated *impairment losses* (3.25).

Allowed alternative treatment

3.11 Subsequent to initial recognition as an asset, an item of property, plant or equipment should be carried at a revalued amount (its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses). Revaluations should be made with sufficient regularity so that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

3.12 The fair value of land and buildings is usually the market value. This value is determined by appraisal, which is normally undertaken by professionally qualified valuers.

3.13 The fair value of items of plant and equipment is usually the market value determined by appraisal. When there is no evidence of market value because of the specialized nature of the plant and equipment and because these items are rarely sold, except as part of a continuing business, they are valued at their depreciated replacement cost.

3.14 When an item of property, plant or equipment is revalued, any accumulated depreciation at the date of the revaluation is either:

(a) Restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount (this method is often used when an asset is revalued by means of an index to its depreciated replacement cost); or

(b) Eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. For example, this method is used for buildings which are revalued to their market value.

3.15 The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in carrying amount, in accordance with paragraporand equipment is revalued, the entire class of property, plant or equipment to which that asset belongs should be revalued.

3.16 When an asset's carrying amount is increased as a result of a revaluation, the increase should be credited directly to equity under the heading of revaluation surplus. However, a revaluation increase should be recognized as income to the extent that it reverses a revaluation decrease of the same asset previously recognized as an expense.

3.17 When an asset's carrying amount is decreased as a result of a revaluation, the decrease should be recognized as an expense. However, a revaluation decrease should be charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation surplus in respect of that same asset.

3.18 The revaluation surplus included in equity may be transferred directly to retained earnings when the surplus is realized. The whole surplus may be realized on the retirement or disposal of the asset. However, some of the surplus may be realized as the asset is used by the enterprise; in such a case, the amount of the surplus realized is the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. The transfer from revaluation surplus to retained earnings is not made through the income statement.

Depreciation

3.19 The *depreciable amount* of an item of property, plant or equipment should be allocated on a systematic basis over its *useful life*. The depreciation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. The depreciation charge for each period should be recognized as an expense unless it is included in the carrying amount of another asset.

3.20 The economic benefits embodied in an item of property, plant or equipment are consumed by the enterprise principally through the use of the asset. However, other factors such as technical obsolescence and wear and tear while an asset remains idle often result in the diminution of the economic benefits that might have been expected to be available from the asset. Consequently, all the following factors need to be considered in determining the useful life of an asset:

(a) the expected usage of the asset by the enterprise (usage is assessed by reference to the asset's expected capacity or physical output);
(b) the expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used, the repair and maintenance programme of the enterprise, and the care and maintenance of the asset while idle;
(c) technical obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or the service output of the asset; and
(d) legal or similar limits on the use of the asset, such as the expiry dates of related *leases*.

3.21 Land and buildings are separable assets and are dealt with separately for accounting purposes, even when they are acquired together. Land normally has an unlimited life and, therefore, is not depreciated. Buildings have a limited life and, therefore, are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the useful life of the building.

3.22 A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the sum-of-the-units method. Straight-line depreciation results in a constant charge over the useful life of the asset. The diminishing balance method results in a decreasing charge over the useful life of the asset. The sum-of-the-units method results in a charge based on the expected use or output of the asset. The method used for an asset is selected based on the expected pattern of economic benefits and is consistently applied from period to period unless there is a change in the expected pattern of economic benefits from that asset.

3.23 The useful life of an item of property, plant or equipment should be reviewed periodically and, if expectations are significantly different from previous estimates, the depreciation charge for the current and future periods should be adjusted.

3.24 The depreciation method applied to property, plant and equipment should be reviewed periodically and, if there has been a significant change in the expected pattern of economic benefits from those assets, the method should be changed to reflect the changed pattern. When such a change in depreciation method is necessary, the change should be accounted for as a change in accounting estimate and the depreciation charge for the current and future periods should be adjusted.

Impairment

3.25 At each balance sheet date, the entity should review the carrying value of all tangible and intangible fixed assets and consider whether the continued use of the asset, or group of assets forming a cash generating unit, is likely to generate cash flows sufficient to absorb the amortization of the cost of the asset. In the event that the future flows are expected to be insufficient, the carrying value should be reduced.

Retirements and disposals

3.26 An item of property, plant or equipment should be eliminated from the balance sheet on disposal or when the asset is permanently withdrawn from use and no future economic benefits are expected from its disposal.

3.27 Gains or losses arising from the retirement or disposal of an item of property, plant or equipment should be determined as the difference between the estimated net disposal proceeds and the carrying amount of the asset and should be recognized as income or expense in the income statement.

Disclosure

3.28 The financial statements should disclose, for each class of property, plant and equipment:

(a) the measurement bases used for determining the gross carrying amount (when more than one basis has been used, the gross carrying amount for that basis in each category should be disclosed);
(b) the depreciation methods used;
(c) the useful lives or the depreciation rates used;

(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and

(e) a reconciliation of the carrying amount at the beginning and end of the period showing:
  (i) additions;
  (ii) disposals;
  (iii) increases or decreases during the period resulting from revaluations;
  (iv) impairment losses recognized in the income statement during the period (if any);
  (v) impairment losses reversed in the income statement during the period (if any);
  (vi) depreciation; and
  (vii) other movements.

Comparative information is not required for the reconciliation in (e) above.

3.29 The financial statements should also disclose the existence and amounts of restrictions on title, as well as property, plant and equipment pledged as security for liabilities.

3.30 When items of property, plant and equipment are stated at revalued amounts, the following should be disclosed:

(a) the basis used to revalue the assets;
(b) the effective date of the revaluation; and
(c) whether an independent valuer was involved.

Guideline 4. Leases

Classification of leases

4.1 The classification of leases is based on the extent to which risks and rewards incident to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibility of losses from idle capacity or technological obsolescence and of variations in return caused by changing economic conditions. Rewards may be represented by the expectation of profitable operation over the asset's *economic life* and of gain from appreciation in value or realization of a residual value.

4.2 Whether a lease is a *finance lease* or an *operating lease* depends on the substance of the transaction rather than the form of the contract. Following are examples of situations that would normally lead to a lease's being classified as a finance lease:

(a) the lease transfers ownership of the asset to the lessee by the end of the *lease term*.

(b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that, at the *inception* of the lease, it is reasonably certain that the option will be exercised.

(c) the lease term is for the major part of the economic life of the asset, even if title is not transferred.

(d) at the inception of the lease, the present value of the *minimum lease payments* amounts to at least substantially all of the fair value of the leased asset.

(e) the leased assets are of a specialized nature such that only the lessee can use them without major modifications.

4.3 Following are indicators of situations that, individually or in combination, could also lead to a lease's being classified as a finance lease:

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee.

(b) gains or losses from the fluctuation in the fair value of the residual fall to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease).

(c) the lessee has the ability to continue the lease for a secondary period at a rent substantially lower than market rent.

Finance leases

4.4 Lessees should recognize finance leases as assets and liabilities in their balance sheets at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. In calculating the present value of the minimum lease payments, the discount factor is the *interest rate implicit in the lease*, if this is practicable to determine; if not, the lessee's incremental borrowing rate should be used.

4.5 Lease payments should be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge should be allocated to periods during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

4.6 A finance lease gives rise to a depreciation expense for the asset as well as a finance expense for each accounting period. The depreciation policy for leased assets should be consistent with that for depreciable assets that are owned.

4.7 If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the lease term or its useful life, whichever is shorter.

4.8 Lessees should disclose for finance leases, for each class of asset, the net carrying amount at the balance sheet date and the basis on which *contingent rents* have been recognized in the income statement.

Operating leases

4.9 Lease payments under an operating lease should be recognized as an expense in the income statement on a straight line basis over the lease term unless another systematic basis is representative of the time pattern of the user's benefit.

4.10 All incentives for the agreement of a new or renewed operating lease should be recognized as an integral part of the net consideration agreed for the use of the leased asset. The lessee should recognize the aggregate benefit of incentives as a reduction of rental expense over the lease term.

4.11 Lessees should disclose the total of future minimum lease payments under non-cancellable operating leases for each of the following periods:

(i) not later than one year;
(ii) later than one year and not later than five years; and
(iii) later than five years.

Sale and leaseback

4.12 A sale and leaseback transaction involves the sale of an asset by the vendor and the leasing of the same asset back to the vendor. The lease payment and the sale price are usually interdependent since they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends on the type of lease involved.

4.13 If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount should not be immediately recognized as income in the financial statements of a seller-lessee. Instead, it should be deferred and amortized over the lease term.

4.14 If a sale and leaseback transaction results in an operating lease and it is clear that the transaction is established at fair value, any profit or loss should be recognized immediately. If the sale price is below fair value, any profit or loss should be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it should be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortized over the period for which the asset is expected to be used.

4.15 For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognized immediately.

Guideline 5. Intangible Assets

Definition

5.1 An enterprise *controls* an asset if the enterprise has the power to obtain the future economic benefits flowing from the underlying resource and also can restrict the access of others to those benefits. The capacity of an enterprise to control the future economic benefits from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control since an enterprise may be able to control the future economic benefits in some other way.

Recognition and initial measurement of an intangible asset

5.2 An intangible asset should be recognized if, and only if:

(a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and
(b) the *cost* of the asset can be measured reliably.

5.3 An enterprise should assess the probability of future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

5.4 An intangible asset should be measured initially at cost.

5.5 Internally generated goodwill should not be recognized as an asset.

Internally generated intangible assets

Research phase

5.6 No intangible asset arising from *research* (or from the research phase of an internal project) should be recognized. Expenditure on research (or on the research phase of an internal project) should be recognized as an expense when it is incurred.

Development phase

5.7 An intangible asset arising from *development* (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the following:

(a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;
(b) The enterprise's intention to complete the intangible asset and use or sell it;
(c) its ability to use or sell the intangible asset;
(d) how the intangible asset will generate probable future economic benefits (among other things, the enterprise should demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset);
(e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
(f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

5.8 Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance should not be recognized as intangible assets.

Recognition of an expense

5.9 Expenditure on an intangible item should be recognized as an expense when it is incurred, unless it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 5.2 to 5.8).

5.10 Expenditure on an intangible item that was initially recognized as an expense by a reporting enterprise in previous annual financial statements or interim financial reports should not be recognized as part of the cost of an intangible asset at a later date.

5.11 Subsequent expenditure on an intangible asset after its purchase or its completion should be recognized as an expense when it is incurred unless:

(a) it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance; and
(b) this expenditure can be reliably measured and attributed to the asset.
If these conditions are met, the subsequent expenditure should be added to the cost of the intangible asset.

5.12 After initial recognition, an intangible asset should be carried at its cost less any accumulated amortization and any accumulated impairment losses. If fair value can be determined by reference to an *active market*, revaluation is an allowed alternative treatment.

Amortization

Amortization period

5.13 The depreciable amount of an intangible asset should be allocated on a systematic basis over the best estimate of its useful life. There is a rebuttable presumption that the useful life of an intangible asset will not exceed 20 years from the date when the asset is available for use. Amortization should commence when the asset is available for use.

5.14 If control over the future economic benefits from an intangible asset is achieved through legal rights that have been granted for a finite period, the useful life of the intangible asset should not exceed the period of the legal rights unless:

(a) the legal rights are renewable; and
(b) renewal is virtually certain.

Amortization method

5.15 The amortization method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise. If that pattern cannot be determined reliably, the straight-line method should be used. The amortization charge for each period should be recognized as an expense unless another Guideline permits or requires it to be included in the carrying amount of another asset.

Residual value

5.16 The *residual value* of an intangible asset should be assumed to be zero unless:

(a) there is a commitment by a third party to purchase the asset at the end of its useful life; or
(b) there is an active market for the asset and:
    (i) residual value can be determined by reference to that market; and
    (ii) it is probable that such a market will exist at the end of the asset's useful life.

Review of amortization period and amortization method

5.17 The amortization period and the amortization method should be reviewed at least at the end of each financial year. If the expected useful life of the asset is significantly different from previous estimates, the amortization period should be changed accordingly. If there has been a significant change in the expected

pattern of economic benefits from the asset, the amortization method should be changed to reflect the changed pattern. Such changes should be accounted for as changes in accounting estimates by adjusting the amortization charge for the current and future periods.

Recoverability of the carrying amount: impairment losses

5.18 An enterprise should estimate the recoverable amount of intangible assets at least at the end of each financial year, even if there is no indication that the asset is impaired. The recoverable amount should be determined under paragraph 3.25 and impairment losses recognized accordingly.

Retirements and disposals

5.19 An intangible asset should be derecognized (eliminated from the balance sheet) on disposal or when no future economic benefits are expected from its use and subsequent disposal.

5.20 Gains or losses arising from the retirement or disposal of an intangible asset should be determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognized as income or expense in the income statement.

Disclosure

5.21 The financial statements should disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

(a) the useful lives or the amortization rates used;
(b) the amortization methods used;
(c) the gross carrying amount and the accumulated amortization (aggregated with accumulated impairment losses) at the beginning and end of the period;
(d) the line item(s) of the income statement in which the amortization of intangible assets is included; and
(e) a reconciliation of the carrying amount at the beginning and end of the period showing:
    (i) retirements and disposals;
    (ii) impairment losses recognized;
    (iii) impairment losses reversed;
    (iv) amortisation recognized during the period; and
    (v) additions and other changes in the carrying amount during the period.

Comparative information is not required.

5.22 The financial statements should also disclose:

(a) if an intangible asset is amortized over more than 20 years, the reasons why the presumption that the useful life of an intangible asset will not exceed 20 years from the date when the asset is available for use is rebutted.

(b) a description, the carrying amount and remaining amortization period of any individual intangible asset that is material to the financial statements of the enterprise as a whole; and

(c) the existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities.

Guideline 6. Inventories

6.1 Inventories should be measured at the lower of cost and net realizable value.

6.2 The cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

6.3 The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects should be assigned by using specific identification of their individual costs.

6.4 The cost of inventories, other than those dealt with in paragraph 6.3, should be assigned by using the first-in, first-out (FIFO) or weighted average cost formulas.

Recognition as an expense

6.5 When inventories are sold, the carrying amount of those inventories should be recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realizable value and all losses of inventories should be recognized as an expense in the period in which the write-down or loss occurs. The amount of any reversal of any write-down of inventories arising from an increase in net realizable value should be recognized as a reduction in the amount of inventories recognized as an expense in the period in which the reversal occurs.

Disclosure

6.6 The financial statements should disclose:

(a) the accounting policies adopted in measuring inventories, including the cost formula used;
(b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the enterprise; and
(c) the carrying amount of inventories pledged as security for liabilities.

6.7 The financial statements should disclose either:

(a) the cost of inventories recognized as an expense during the period; or
(b) the operating costs, applicable to revenues, recognized as an expense during the period, classified by their nature.

Guideline 7. Government Grants

7.1 *Government grants* are assistance by *government* in the form of transfers of resources to an enterprise in return for past or future compliance with certain conditions relating to the operating activities of the enterprise.

7.2 Government grants, including non-monetary grants at fair value, should not be recognized until there is reasonable assurance that:

(a) the enterprise will comply with the conditions attaching to them; and
(b) the grants will be received.

7.3 Government grants should be recognized as income over the periods necessary to match them with the related costs they are intended to compensate, on a systematic basis. They should not be credited directly to shareholders' interests.

7.4 In most cases the periods over which an enterprise recognizes the costs or expenses related to a government grant are readily ascertainable, and thus grants in recognition of specific expenses are recognized as income in the same period as the relevant expense. Similarly, grants related to depreciable assets are usually recognized as income over the periods and in the proportions in which depreciation on those assets is charged.

7.5 A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the enterprise, with no future related costs, should be recognized as income of the period in which it becomes receivable, as an extraordinary item if appropriate.

7.6 Government *grants related to assets*, including non-monetary grants at fair value, should be presented in the balance sheet either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.

7.7 *Grants related to income* are sometimes presented as a credit in the income statement, either separately or under a general heading such as "Other income"; alternatively, they are deducted in reporting the related expense.

7.8 A government grant that becomes repayable should be accounted for as a revision to an accounting estimate. Repayment of a grant related to income should be applied first against any unamortized deferred credit set up in respect of the grant. To the extent that the repayment exceeds any such deferred credit, or where no deferred credit exists, the repayment should be recognized

immediately as an expense. Repayment of a grant related to an asset should be recorded by increasing the carrying amount of the asset or reducing the deferred income balance by the amount repayable. The cumulative additional depreciation that would have been recognized to date as an expense in the absence of the grant should be recognized immediately as an expense.

Government assistance

7.9 Excluded from the definition of government grants in paragraph 7.1 are certain forms of *government assistance* that cannot reasonably have a value placed on them and transactions that cannot be distinguished from the normal trading transactions of the enterprise.

7.10. Examples of assistance that cannot reasonably have a value placed on them are free technical or marketing advice and the provision of guarantees. An example of assistance that cannot be distinguished from the normal trading transactions of the enterprise is a government procurement policy that is responsible for a portion of the enterprise's sales. The existence of the benefit might be unquestioned, but any attempt to segregate the trading activities from government assistance could well be arbitrary.

7.11 The significance of the benefit in the above examples may be such that disclosure of the nature, extent and duration of the assistance is necessary so that the financial statements will not be misleading.

7.12 Loans at nil or low interest rates are a form of government assistance, but the benefit is not quantified by the imputation of interest.

7.13 Government assistance to enterprises meets the definition of government grants even if there are no conditions specifically relating to the operating activities of the enterprise other than the requirement to operate in certain regions or industry sectors. Such grants should therefore not be credited to equity.

Disclosure

7.14 The following matters should be disclosed:

(a) the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements;
(b) the nature and extent of government grants recognized in the financial statements and an indication of other forms of government assistance from which the enterprise has directly benefited; and
(c) unfulfilled conditions and other contingencies attaching to government assistance that has been recognized.